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February 17, 2009

AGENDA ITEM 10b

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Corporate Board Diversity Update
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Information
- IV. ANALYSIS:**

Executive Summary

Corporate board diversity is an important attribute in defining how each director fits within the skill sets necessary for a company to be competitive in the evolving global market place. A corporate board of directors should establish and disclose the mix of director attributes, experiences, diverse perspectives, and skill sets most appropriate to focusing attention on optimizing company operating performance and total stock return. With each director nomination recommendation, a corporate board should consider the issue of continuing director tenure, as well as board diversity, and take steps necessary to ensure that the board maintains openness to new ideas and a willingness to critically re-examine the status quo.

Attachment 1 is a white paper completed by Virtcom Consulting, at the direction of the Investment Committee in October 2008, entitled *Board Diversification Strategy: Realizing Competitive Advantage and Shareowner Value*. Key findings in the white paper include:

- A gap remains between ethnic minority and gender representation on corporate boards in Fortune 100 companies versus the general U.S. population.

- Research suggests that companies with more diverse boards, especially gender based diversification, have higher performance and financial metrics such as: Return on Equity, Return on Sales, and Return on Invested Capital.
- Companies that have non-diverse boards or have not integrated a diversity return-on-investment model within their current diversity initiative may be at a competitive disadvantage and underperforming in terms of shareowner value.
- A series of best practices and models for leveraging corporate board diversity to effectively make an impact.

Staff is seeking direction from the Board on next steps to disseminating the white paper and has summarized a series of options in this agenda item for consideration.

Background

The global economy is becoming much more diverse, and successfully competing within this evolving economy requires adaptation and recognition of changing wealth and influence demographics. CalPERS believes that diversity in the boardroom can inherently lead to greater creativity, more vigorous deliberation, and more integrity of processes, all of which are desirable traits and are consistent with principles of good corporate governance.

In March 2008, California State Controller John Chiang requested CalPERS to consider a new initiative to address corporate board diversity (Attachment 2).

In April 2008, the CalPERS Investment Committee directed staff as follows:

- Address corporate board diversity with 2009 Preliminary Focus List Program companies.
- Engage proxy advisors on their board diversity policies with the objective of encouraging them to adopt a principles-based position consistent with CalPERS' position.
- Develop a white paper on best practices for corporate boards to follow in seeking diversity on their boards, including how diversity is linked to performance.

At the October 2008 Investment Committee meeting, staff reported that CalPERS position on corporate board diversity would be discussed with each of the 2009 Preliminary Focus List companies. Staff will report back to the Board on these discussions upon presentation of the 2009 Focus List agenda item at the March 2009 meeting.

Additionally, at the October 2008 meeting staff reported to the Investment Committee on its progress of engaging proxy advisors for the purpose of impressing upon each firm CalPERS position on corporate board diversity. Staff further encouraged leadership from each firm to support initiatives and proposals which enhance shareowner value creation through corporate board diversity. RiskMetrics Group, Glass-Lewis & Co., Proxy Governance, and Egan-Jones Proxy Services each provided staff with a forum for urging continued robust diligence on broadening their global policies to support initiatives that foster an environment of diverse perspectives and breadth of experiences at all companies. Each of the proxy advisory firms are currently rolling out their 2009 proxy voting principles which will be applied to vote recommendations in director elections, management proposals, and shareowner proposals. Staff will use the upcoming 2009 proxy season to benchmark each proxy advisors vote recommendation on shareowner proposals related to corporate board diversity, in order to measure how receptive each firm has been to supporting this issue.

Finally, at the October 2008 meeting staff updated the Investment Committee with the selection of Virtcom Consulting as the external vendor to be used for completing a white paper on best practices for corporations to follow in seeking diversity on their boards, including how diversity can be linked to performance. The scope of the white paper will also provide a current snap-shot of baseline information on the diverse composition of corporate boards, to the extent that data was readily available.

Next Steps: Options to Disseminate White Paper

Effectively impacting corporate board diversity, as referenced in California State Controller John Chiang's letter, requires some distinction in the categories of activity that is warranted by the differing breadth of company coverage attached to the various corporate governance activities. CalPERS endeavors to impact the behavior of the entire marketplace by publicizing the organization's position on various topics, along with encouraging other entities to adopt CalPERS position. In contrast to the more broad market based approach, CalPERS ventures to impact corporate governance practices at individual companies through more direct and targeted engagement initiatives. For example, individual company engagement normally happens in conjunction with the annual Focus List process, environmental engagement initiative, or majority vote initiative.

The Board may consider the following options for disseminating the white paper to impact the behavior of the entire marketplace or a more targeted initiative to impact the behavior of individual company boards of directors. CalPERS could proactively promote and distribute the white paper in 2009 through:

1. CalPERS' existing affiliations or memberships with investor based forums. Staff could reach out to each investor group for the purpose of identifying

opportunities to present the white paper to each forum's membership base. Opportunities in 2009 could range from encouraging panel discussion, working group participation, and policy review focused on corporate board diversity. The following investor groups would be recommended for consideration:

- Council of Institutional Investors
 - International Corporate Governance Network
 - Asian Corporate Governance Association
 - Stanford Institutional Investors Forum
 - United Nations Principles for Responsible Investment
 - Los Angeles Area Pension Trustees Network
2. Groups or member forums that directly impact corporate directors. The following groups and forums would be recommended for consideration:
- National Association of Corporate Directors (NACD)
 - Society of Corporate Secretaries
 - The Conference Board
 - Stanford Directors Forum
3. CalPERS portfolio companies (up to 20 companies) within the Fortune 100 that show a significant gap between ethnic minority or gender representation versus the general U.S. population as defined in the white paper. CalPERS would request a response to how each company board of directors either already implements similar best practices; or, provide CalPERS with a response as to why the best practices detailed in the white paper would not add value to the company becoming more competitive in the evolving global market place.
4. CalPERS' Global Principles of Accountable Corporate Governance to identify potential amendments that more directly convey the best practices described in the white paper.
5. Conferences, forums, or workshops that focus directly on corporate diversity such as that being planned in the Fall of 2009 in collaboration with CalSTRS and The Arthur and Toni Rembe Rock Center for Corporate Governance at Stanford University.

The options presented in this agenda item provide a range of broad market based and company-specific considerations.

V. STRATEGIC PLAN:

This item will further the following goals of CalPERS Strategic Plan:

- Goal VIII. Manage the risk and volatility of assets and liabilities to ensure sufficient funds are available, first, to pay benefits and second, to minimize and stabilize contributions.
- Goal IX. Achieve long-term, sustainable, risk adjusted returns.

VI. RESULTS/COSTS:

Market dissemination of the Board Diversity White Paper will incur incremental costs to CalPERS and be dependent on feedback from the Investment Committee. These efforts are viewed as advancing the organizations' diversity objectives and raising the awareness level of the topic.

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